disparate rate centers. To allow such long-haul transport without transport compensation would be unfair for the ILEC, which bears the cost of its transport network. Further, such a policy in regards to VNXX, once widely adopted by the CLEC industry would potentially result in a shift in the cost of such transport to local exchange subscribers rather than to the subscribers of VNXX service which is the beneficiary of the foreign exchange like service.[10]

Pac-West has developed its VNXX product largely to serve its ISP customers, a substantial part of its business. VNXX is a valuable service that subscribers are willing to pay a premium for. Such service rates should bear the costs associated with provisioning the service. SBC offers a similar product as foreign exchange service. The FAR would have SBC provide transport services for non-local VNXX traffic without charge to its competitors while bearing the full cost of transport for provisioning its own foreign exchange service. Such a scenario is unreasonable. CLECs are free to compete utilizing wholesale services of the ILEC, other CLEC transport providers, or to provision transport services themselves.

The policies of this Commission and the Telecom Act precisely intends for carriers to invest in facilities based on the innovation incentives inherent in an openly competitive market. We refrain from creating an incentive that distorts marketplace investments by requiring incumbents to either subsidize its competitors' or shift costs to local exchange customers for inter-exchange traffic that is destined beyond the origination rate center. Such policy would encourage CLECs to become providers of termination facilities, to collect reciprocal compensation and thereby avoid investment in multiple points of

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[10] ILECs could claim transport costs should be allocated to local calling costs in any proceeding addressing local exchange costs.

interconnection, switching, and transport, and result in less network redundancy than facilities based competition economics would otherwise dictate. The competitive challenge is both on the CLECs and ILECs to invest wisely in origination and termination facilities.

b. Approval of the Agreement

Rule 4.2.2 specifies that our approval or rejection of an arbitrated ICA must be "pursuant to [Telecommunications Act Subsection] 252 (e) and all of its subparts." Rule 4.2.3. articulates standards under that statute for conducting our review: we may reject the ICA if it does not meet the requirements of Section 251; specific pricing standards set forth in that section; the FCC's implementing regulations prescribed under that section; or other requirements of this Commission, including quality of service standards we have adopted. Taken together, this means that we must examine the ICA to ascertain that it comports with Section 252 (d) and (e), Section 251 and the FCC rules thereunder, and our own regulatory requirements, but that we may also exercise our discretion in applying the standards and granting approval.

We have examined the conformed agreement filed by the parties, and have determined that approval with modification to Issue 14, should be granted. The pricing provisions comply with the standards for interconnection and network element charges, as well as the charges for transport and termination of traffic, under Section 252(d). The ICA does not discriminate against nonparties, and is consistent with the public interest, convenience and necessity, and thus comports with Section 252 (e)(2)(A). It also satisfies the requirements of Section 251 and the FCC's implementing rules, and thereby satisfies Section 252(e)(2)(B). Lastly, the agreement satisfies our own regulatory requirements. In making these determinations we have considered the controversy concerning Issue 14, as discussed above. We will approve the ICA with modification of Issue 14.

5. Application 02-03-059 is closed.

This order is effective today.

Dated May 08, 2003 at San Francisco, California.

CARL W. WOOD
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

I dissent.

/s/ MICHAEL R. PEEVEY
President

I dissent.

/s/ LORETTA M. LYNCH
Commissioner

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held April 17, 2003

Commissioners Present:

Glen R. Thomas, Chairman
Robert K. Bloom, Vice Chairman
Aaron Wilson, Jr.
Terrance J. Fitzpatrick
Kim Pizzingrilli

Petition of US LEC of Pennsylvania, Inc. for Arbitration with Verizon Pennsylvania Inc. Pursuant to Section 252(b) of the Telecommunications Act of 1996

A-310814F7000

OPINION AND ORDER

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be defined by the FCC to accomplish the spirit of the two conditions listed above in this paragraph, without formal amendment to this Agreement.

Incorporating the above language as a condition of the Agreement will ensure that traffic destined to ISPs will be characterized on a neutral basis in accordance with the present FCC rules as well as any potential changes in the FCC rules. We are hopeful that it will also alleviate the Parties concerns about any delays associated with Applicable Law arguments that may occur in the future.

Therefore, we shall grant US LEC's Exceptions in part, and deny them, in part, consistent with this discussion, and modify the ALJ's recommendation consistent with the discussion above.

5. Issue No. 6: (a) Should the parties be obligated to compensate each other for calls to numbers with NXX codes associated with the same local calling area?

(b) Should Verizon be able to charge originating access to US LEC on calls going to a particular NXX code if the customer assigned the NXX is located outside of the local calling area associated with that NXX code? (*See* Petition, p. 16).

a. Position of the Parties

This issue deals with compensation for foreign exchange (FX) traffic. The first part of the issue concerns whether the Parties should pay reciprocal compensation for calls with NXX codes[20] in the same local calling area. The second part concerns the

20 NXX codes represent the second set of three digit numbers following the area code in a ten digit number.

use of Virtual NXX (VNXX) Codes and whether the Parties, particularly Verizon, should be able to charge originating access to one another when calls originating on one network terminate with a customer on the other network who has an assigned NXX code in a local calling area where the terminating customer has no physical presence. (R.D., p. 30).

(i) FX Service

US LEC described a traditional FX arrangement as those instances when a customer was assigned a NPA/NXX code in a local calling area where the customer had no physical presence. US LEC explained that if an originating customer on one network dialed an FX customer in the same local calling area on the other network, the call would be rated as a local call, and the terminating party would be entitled to reciprocal compensation. *See* US LEC M.B., pp. 34-35. US LEC noted that: (1) historically, calls were rated and routed according to their NPA/NXX codes; (2) calls placed to NPA/NXX codes in the same local calling area were rated as local calls; (3) if the originating customer were served by one party and the terminating customer were served by the other party, the originating party would be responsible for paying reciprocal compensation to the terminating party; and (4) if the originating caller was in a local calling area different from the terminating customer, the call would be rated as an intraLATA toll call.

US LEC claimed that FX services offered by Verizon and itself are functionally similar. Also, US LEC pointed out that Verizon admitted to billing and receiving reciprocal compensation from CLECs whose customers called Verizon FX customers. (R.D., pp. 30-31).

After disputing Verizon's characterizations of US LEC's FX service, US LEC pointed out the following public interest benefits to continuing to treat this traffic as local for all purposes, including intercarrier compensation: (1) it provides CLEC customers with a local presence in additional local calling areas (Montano Direct, pp. 20-21); (2) it allows businesses using FX to expand in the geographic area that they can reach with local calls (Tr. 25:9-14); (3) treating these calls as local is consistent with the way Verizon has always treated its own FX service (Tr. 189:25-195:9), Enhanced IntellilinQ PRI Hub Service (Tr. 195:20-205:20) and Internet Protocol Routing Service ("IPRS") (Tr. 205:21-208:14); and (4) CLEC FX service provides a competitive alternative to the FX services provided by Verizon. (Montano Direct, p. 21). (R.D., pp. 31-32 *citing* US LEC MB, p. 37).

US LEC claimed that Verizon's proposal would increase US LEC's costs by denying it intercarrier compensation and imposing access charges on this traffic, both of which would make it uneconomic for US LEC to offer its version of FX service. Based on the foregoing, US LEC contended that Verizon's proposal would harm the public interest and hurt competition. US LEC further noted that the same arguments made by Verizon in this matter were considered and rejected in favor of the CLEC position in the *VA Arbitration Order* at §301. US LEC also highlighted the fact that the Commissions in North Carolina, Kentucky and Michigan, as well as the Florida Commission Staff, agreed with the FCC Wireline Bureau and US LEC. (R.D., p. 32).

US LEC, citing the *VA Arbitration Order,* disputed Verizon's suggestion that US LEC's FX service violated federal law. US LEC submitted that the D.C. Circuit Court specifically rejected the same reasoning in the *ISP Remand Order* that Verizon advocated in this case. (R.D., pp. 33-34).

US LEC argued that adoption of Verizon's plan would compensate Verizon for services it did not provide and costs it did not incur. US LEC argued that the cost to Verizon to carry a call from a Verizon customer to a US LEC FX customer was the same as from the same Verizon customer to a US LEC customer in the local calling area. In other words, Verizon was not, according to US LEC, losing toll revenue because it was only transporting a local call in both situations. According to US LEC, it makes no sense for Verizon to recover "lost toll revenue" in the FX scenario from US LEC because US LEC was still required to carry the FX call to the physical location for the US LEC customer. (R.D., p. 33; US LEC M.B., pp. 45-47).

Verizon alleged that VNXX codes as proposed to be used by US LEC violate this Commission's prior decisions that require carriers to assign customers NXX codes that correspond with the rate centers where the customers are physically located. *See,* R.D., p. 38 citing *Petition of Focal Communications Corporation of Pennsylvania for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement With Bell Atlantic-Pennsylvania, Inc.*, Docket No. A-310630F0002; (Opinion and Order, entered January 29, 2001) slip op., p. 11 (*Focal Order*); and *Level 3 Communications, LLC v. Marianna & Scenery Hill Telephone Company,* Opinion and Order, entered August 8, 2002, at Docket No. C-20028114 (*Level 3 Order*). (R.D., p. 38).[21]

US LEC disagreed with Verizon's allegations that US LEC's VNXX service violated this Commission's precedent.

Verizon disputed US LEC's representation that reciprocal compensation for FX traffic was the historical practice in the industry. Verizon argued that prior to 1996,

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[21] In *Level 3LLC v. Marianna & Scenery Hill Telephone Company*, Docket No. C-20028114, three orders were entered. On August 8, 2002, this Commission granted, with conditions, a petition of Level 3 for emergency relief. By Order entered October 11, 2002, we granted reconsideration but kept in place certain restrictions on the assignment by Level 3 of new telephone numbers to new ISP customers pending an investigation of whether Level 3's practices complied with applicable law. By Order entered January 27, 2003, we adopted the Recommended Decision of ALJ Michael C. Schnierle, in substantial part, and dismissed, without prejudice, the Formal Complaint of Level 3. We also vacated the numbering administration restrictions imposed as well.

there was no historical practice associated with payment of reciprocal compensation on FX traffic because incumbent LECs did not pay reciprocal compensation. Verizon noted that there is, however, a clear historical practice with respect to interLATA FX arrangements and that federal law requires access charges, not reciprocal compensation, for interLATA FX traffic.[22] Verizon pointed out that US LEC has the potential to violate the law because it offers interLATA FX service and is easily able to bill Verizon for reciprocal compensation for those calls. (R.D., p. 37).

Verizon claimed that the cases cited by US LEC to support reciprocal compensation payments for FX traffic were a minority view. Verizon pointed out that nothing in Verizon's proposal prevented US LEC from offering virtual FX, but merely that US LEC and its customers should be required to pay for it. *See* VZ R.B., pp. 20-21; R.D., p. 37. Verizon noted the following states are in agreement that reciprocal compensation should not apply to virtual NXX traffic because it does not physically originate and terminate in the same local calling area: Ohio, Florida, Connecticut, Illinois, Texas, South Carolina, Tennessee, Georgia and Missouri. (R.D., pp. 35-36; VZ M.B., pp. 33-34).

Verizon also relied upon FCC's rules and statements in the *Local Competition Order* and the *ISP Remand Order*, for the proposition that reciprocal compensation does not apply to the transport and termination of interstate and intrastate interexchange traffic because the call does not originate and terminate in the same local calling area. Verizon suggested that the applicable portion of the *VA Arbitration Order* failed to follow federal law. (R.D., pp. 35-36).

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[22] *See AT&T Corp. v. Bell Atlantic-Pennsylvania*, 14 FCC Rcd 556, ¶71 (1998), *reconsideration denied*, 14 FCC Rcd 7467 (2000).

Verizon asserted that the payment of reciprocal compensation would be anti-competitive. Verizon stressed that US LEC's FX customers pay fees to US LEC for the service in lieu of the toll charges that Verizon would have otherwise collected from Verizon's customers even though Verizon continues to incur the costs of delivering Verizon originated FX traffic to the US LEC switch. Verizon also submitted that allowing reciprocal compensation for FX traffic discouraged CLECs from deploying facilities in remote areas to compete with Verizon's facilities. Verizon emphasized that, contrary to US LEC's representation that US LEC was carrying the toll portion of the FX call, US LEC's FX service gave it a free ride on Verizon's facilities. As such, Verizon argued that if US LEC continued to offer FX service, US LEC should be required to pay access charges to Verizon for this traffic. (R.D., pp. 37-38).

Verizon also contended that permitting reciprocal compensation for delivering FX traffic to US LEC is a form of regulatory arbitrage. Verizon believed that US LEC's FX system was designed to deprive Verizon of the toll revenue from its customers who wished to call US LEC FX customers. Verizon considered it unfair to require Verizon to pay reciprocal compensation for US LEC FX traffic when Verizon bore the costs for originating and transporting the interexchange call. Verizon asserted that US LEC failed to provide evidence that it incurred any additional charges different from providing local service. Verizon noted that US LEC specifically justified the charges for its FX services by informing its customers that they were paying the toll charges for the incoming calls. Verizon also accused US LEC of manipulating number assignments to deprive Verizon of the toll charges that should have been paid by the Verizon customer. Verizon argued that Verizon's originating call costs were being inflated because US LEC only had one switch per LATA. Verizon believed that it should be compensated for its lost toll revenue and that reciprocal compensation should only be due for calls originating and terminating within the same local exchange. *See* R.D., p. 36.

In response to Verizon's claim that US LEC's FX plan resulted in regulatory arbitrage, US LEC pointed out that its FX plan was fundamentally similar to Verizon's and that traffic between the two carriers was relatively balanced. US LEC also alleged that Verizon had about 6,000 FX customers in Pennsylvania as compared to six for US LEC and that the charges to their customers were roughly equal. US LEC explained that each carrier received reciprocal compensation for transporting FX calls to the other and that there was no lost toll revenue. US LEC asserted that Verizon's "lost toll revenue" argument rested on the faulty assumption that Verizon's customers would be willing to incur toll charges to dial the same US LEC customers without FX service. (R.D., p. 34).

As a related attack on US LEC's proposed FX service, Verizon argued that US LEC's tariffed Local Toll-Free service provided interLATA FX service in violation of federal law. Verizon asserted that the same federal prohibition for paying reciprocal compensation for interLATA calls should also apply to intraLATA calls. *See* R.D., p. 36; VZ M.B., pp. 31-32, 38-39. In response, US LEC emphasized that Verizon erroneously characterized US LEC's tariffed Local Toll Free Service as an FX service because Verizon failed to notice that US LEC offered a tariffed Foreign Exchange local service. US LEC contended that there was no evidentiary support for Verizon's allegations that US LEC billed Verizon for reciprocal compensation for carrying Verizon traffic to US LEC Local Toll Free Service customers and that there was no evidence that US LEC had Local Toll Free Service customers in Pennsylvania. *See* R.D., p. 34. Therefore, US LEC averred that Verizon's concerns about a service entitled "Local Toll Free Service" bore no relationship to US LEC's FX Service and should be ignored by the Commission in determining this issue.

Finally, US LEC regarded Verizon's suggestions to fix the FX system as intrusive, unworkable and expensive. These suggestions would, *inter alia*, require creating an FX customer database, conducting traffic studies, and estimating the amount of traffic which terminated at US LEC FX subscribers. In noting that it only had six Pennsylvania FX customers, US LEC submitted that the expense of Verizon's "cure" could not be recovered from those customers. (R.D., pp. 34-35; VZ M.B., pp. 31-32, 38-39). However, Verizon asserted that distinguishing FX traffic was feasible and that, even if implementation were difficult, it would not excuse the parties from compliance with federal law. *See* R.D., p. 37.

b. ALJ Recommendation

On consideration of the positions of the Parties, the ALJ recommended that US LEC's proposal be adopted as modified by his recommendation in Issue 5, pertaining to the use of the term "other" rather than "terminating" party. (R.D., p. 38). The ALJ concluded that Verizon's position to oppose reciprocal compensation for FX service was substantially undermined by its admission that it offered FX service to its current customers and had collected reciprocal compensation from the other CLECs for terminating CLEC calls to Verizon's FX customers. (*Id.*). The ALJ was not persuaded by Verizon's offer to change that practice for US LEC in view of the current industry practice in Pennsylvania. (*Id.*).

The ALJ found that the rendition of FX service in Pennsylvania is not illegal. He noted that both US LEC and Verizon have Commission-approved tariffs on file that allow them to offer intraLATA FX service to their customers.[23]

Therefore, ALJ Cocheres concluded that the central issue concerns whether US LEC should be permitted to render FX service using a virtual NXX format. (R.D., p. 39). On this issue, the ALJ was persuaded by the FCC Wireline Bureau's conclusion in the *VA Arbitration Order*. After reviewing the VNXX issue and the same arguments

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23 VZ Exh. 4 (US LEC tariff), original page 22. Haynes Rebuttal Test., pp. 5-6.

made by the Parties, the FCC Staff rejected Verizon's position and adopted the position advocated by the CLECs. The pertinent reasoning of the FCC Wireline Bureau is reprinted, below:

> 301. We agree with the petitioners that Verizon has offered no viable alternative to the current system, under which carriers rate calls by comparing the originating and terminating NPA-NXX codes. We therefore accept the petitioners' proposed language and reject Verizon's language that would rate calls according to their geographical end points. Verizon concedes that NPA-NXX rating is the established compensation mechanism not only for itself, but industry-wide. The parties all agree that rating calls by their geographical starting and ending points raises billing and technical issues that have no concrete, workable solutions at this time.
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> * * *
>
> 303. Additionally, we note that state commissions, through their numbering authority, can correct abuses of NPA-NXX allocations. As discussed earlier, the Maine Commission found that a competitive LEC there was receiving NPA-NXXs for legacy rate centers throughout the state of Maine although it served no customers in most of those rate centers. [n. 994 *See Investigation Into Use of Central Office Codes (NXXs) by New England Fiber Communications, Inc., LLC d/b/a/ Brooks Fiber*, Docket No. 98-78, Maine PUC (rel. June 30, 2000).]
>
> To the extent that Verizon sees equivalent abuses in Virginia, it can petition the Virginia Commission to review a competitive LEC's NPA-NXX allocations.

FCC Wireline Bureau Arbitration Order at §§301-303 (Notes omitted).

The ALJ agreed with the above analysis and adopted it. (R.D., p. 40).

The ALJ also addressed the Parties' arguments concerning this Commission's ruling in the *Focal Order*. In the *Focal Order*, this Commission stated:

With regard to BA-PA's argument that Focal escapes any obligation to pay for the use of BA-PA's transport network by *assigning its customers telephone numbers with NXXs that* misrepresent the actual locations of those customers, we agree with Focal that the alleged transport concerns raised by BA-PA are irrelevant in this proceeding because they are advanced as examples under the existing interconnection agreement between BA-PA and Focal, and not under the agreement that is being arbitrated. (Focal R.Exc., p. 17). At the same time, however, we are of the opinion that if the allegations by BA-PA concerning any abuse by Focal in assigning telephone numbers to customers using NXX codes that do not correspond to the rate centers in which the customers' premises are physically located are true, then we admonish Focal to comply with the directives in our *MFS II Order* and to refrain from this practice.[67] At any rate, it is more appropriate to address the specifics of violation issues in a separate proceeding.

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[67] Failure to comply with this directive will be deemed as a direct violation of this Order and our *MFS II Order* and will be subject to Civil Penalties for Violations under Section 3301 of the Public Utility Code, 66 Pa. C.S. §3301.

(Slip op., p. 43).

The ALJ concluded that there was insufficient evidence to demonstrate whether US LEC was abusing the NXX system. He noted that US LEC has six VNXX customers in Pennsylvania, none of which are ISPs. (R.D., p. 41). He also noted that this Commission has opened an investigation at Docket No. I-00020093 into the use of the NXX system in Pennsylvania and suggested that if there is a problem with US LEC's FX plan, it can be investigated as a part of that proceeding.

Based on the foregoing, and in the interim, the ALJ recommended that the language offered by US LEC in its Best and Final Offer be adopted. Thus, under the

ALJ's recommendation, there would be a continuation of the FX format that each Party is currently using and each Party would continue the practice of paying reciprocal compensation to the other. (R.D., pp. 41-42).

c. Exceptions

In its Exceptions, Verizon emphasizes that it is not challenging the following issues in this arbitration: (1) US LEC's ability to provide VNXX service in this proceeding;[24] (2) the system of end-user call rating based on assigned telephone numbers;[25] (3) the system of routing calls based on those same numbers;[26] and (4) US LEC's ability to serve many local calling areas from a single switch. Rather, Verizon argues that the only issue it is challenging is US LEC's resistance to adequately compensating Verizon for: (1) originating VNXX traffic and delivering it to US LEC's switch and (2) the lost toll revenues that Verizon would have otherwise received. Verizon is of the opinion that the strong weight of state commission determinations and basic principles of regulatory rationality and fairness all support its argument that US LEC should pay Verizon adequate compensation. (VZ Exc., pp. 11-12).

Verizon generally asserts that the ALJ's recommendation on the use of VNXX codes reaches the wrong result with little independent analysis and should be rejected as inconsistent with federal law and this Commission's prior decisions. Verizon states that the recommendation also threatens to promote anticompetitive regulatory arbitrage at the expense of genuine local competition. Verizon submits that the recommended language proposed by US LEC would create opportunities for US LEC to improperly pass off its cost of doing business upon Verizon, thus undermining the development of competition in Pennsylvania. (VZ Exc., pp. 1-2).

24 Haynes Rebuttal, pp. 9:9-11.

25 *Id.*, pp. 2:18-3:4.

26 *Id.*, pp. 2:19-20.

Specifically, Verizon reiterates it position that this Commission, in the *Focal Order*, has prohibited CLECs from assigning telephone numbers to customers using NXX codes that do not correspond to the rate centers in which the customers' premises are physically located. Verizon argues that this Commission reaffirmed that prohibition in the *Level 3 Order* while opening its generic investigation into the use of virtual NXX codes. Verizon submits that although this instant arbitration may not be the proper forum to address the propriety of the use of VNXX codes by US LEC, it presents an issue of first impression for this Commission to resolve if the virtual NXX practice is to be allowed. And, if VNXX is allowed, it presents an issue of first impression for the type of intercarrier compensation that should be used. (VZ Exc., p. 6).

Verizon argues that the ALJ's recommended use of VNXX codes permits US LEC to do nothing more than it would otherwise do when a US LEC customer receives an ordinary local call. Verizon points that US LEC, nevertheless, charges its virtual NXX customers $12,000 per year for this service so that those customers could receive calls from distant callers and at the same time: (1) deprives Verizon of otherwise applicable toll charges; (2) requires Verizon to pay reciprocal compensation on top of the thousands of dollars per year that US LEC already charges its own VNXX customers; and (3) exempts US LEC from paying access charges to Verizon for the use of its facilities in originating and transporting traffic that Verizon alleges to be interexchange traffic. (VZ Exc., p. 7).

Verizon repeats that it does not object to the use of VNXX codes. However, Verizon wants to be adequately compensated for the use of its facilities when US LEC uses them to provide FX-type services. In this regard, Verizon stresses that its traditional FX service is more fair than US LEC's version of FX service. The difference between the traditional FX service Verizon offers and the type of FX service offered by

US LEC via VNXX codes, is that Verizon's service provides local service out of a distant exchange via a dedicated connection, or "private line," between a customer and the distant central office within the local calling area of interest.[27] (VZ Exc., p. 8). As such, Verizon argues that both Verizon and the interconnecting ILEC are adequately compensated. Verizon submits that US LEC's virtual NXX service manipulates the pre-existing regulatory structure for its own advantage by providing a "superficially similar functionality" to Verizon's traditional FX service without adequate compensation for the transport costs that Verizon incurs to complete the call. Verizon provided the following explanation in support of this argument on pp. 9-10 of its Exceptions, which we reprint:

> For example, suppose a Verizon customer physically located in Allentown calls a US LEC customer in Philadelphia. If US LEC assigns its [local] customer a number associated with the [US LEC local] customer's actual location in Philadelphia, Verizon will assess toll charges for that call. Haynes Direct at 6:18-7:1; Tr. 177:8-11 (US LEC's Montano conceding that such a call is not a local call). But, if US LEC assigns its local customer [that is physically located in Philadelphia] a number associated with the Allentown local calling area, Verizon will treat the call [from a Verizon customer physically located in Allentown] as a local call for rating purposes – but Verizon must still transport the call all the way to Philadelphia because US LEC does not have facilities to accept the traffic in Allentown. US LEC is thus able to control whether or not Verizon can charge its customers the toll charges that would ordinarily apply to a call from Allentown to Philadelphia.
>
> In this way, US LEC's Virtual NXX service operates as a toll-free service, where the called party agrees to pay charges in lieu of the toll charges otherwise applicable to the calling party. Haynes Direct at 6:9-13; Hearing Exh. VZ-6 (describing US LEC's virtual NXX service as "toll free" service). Traditional FX service is also a toll-free-type service, but it raised no issues with respect to inter-carrier compensation in a single carrier environment: Verizon would

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[27] Rebuttal Testimony of Terry Haynes ("Haynes Rebuttal"), p. 8, lines 3-5.

> in principle be compensated for lost toll revenues because its FX customer would pay an additional charge for the dedicated connection used to provide the FX service. Haynes Rebuttal at 8:3-7. But, with US LEC's Virtual NXX service, the matter is not so simple because the FX subscriber is no longer a Verizon customer, and the payments in lieu of toll charges are paid not to Verizon, but to US LEC instead. *See* Hearing Exh. VZ-6 (tolls paid by the "called party" – US LEC's customer). Under US LEC's proposal adopted by the ALJ, however, the additional transport costs are still being borne by Verizon, for which it receives no compensation.

Verizon is also concerned about another regulatory complication that is created as a result of VNXX. Verizon argues that since the US LEC network minimizes its investment in Pennsylvania by serving an entire LATA from a single switch, US LEC is able to obtain NXX codes associated with different calling areas that are quite distant from its switch. Consequently, all other local carriers are forced to direct traffic destined for any of those NXX codes to US LEC's single switch in a LATA.[28] Verizon states that this enables US LEC to provide VNXX service without providing any functionality beyond what it ordinarily provides to any other local customer. Verizon asserts that this is in contrast to traditional FX service because US LEC has established no additional facilities (*i.e.*, dedicated connections between the customer's premises and the "foreign" central office) and is being paid simply for providing its customers with toll-free calling arrangements, where the toll charges that are eliminated were previously being paid to Verizon. Verizon also notes that unlike "real" FX service, US LEC's VNXX service is *in-bound* only. This means that US LEC's customers can only receive calls from distant exchanges, but cannot place calls to those same exchanges.[29] This means that, unlike the case with traditional FX Service, US LEC's VNXX customers are not able to make out-bound toll-free calls from the virtual NXX number. (VZ Exc., pp. 10-11).

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28 Haynes Rebuttal at 2:19-22.

29 Hearing Exh. VZ-6.

Verizon continues that the ALJ's recommendation addresses none of these issues. Verizon excepts to the ALJ observation that Verizon has charged reciprocal compensation for traditional FX traffic in light of the fact that before the advent of local competition, reciprocal compensation was not even a possibility. Verizon also complains that the *VA Arbitration Order*, which the ALJ relied on in his reasoning is flawed, not binding on this Commission, and still subject to full FCC review. Verizon distinguishes the facts in that order from the record in the instant proceeding. Verizon notes that the sole basis for the Wireline Bureau's conclusion – that it would be difficult for the parties to distinguish local traffic from VNXX traffic – is not true in this case. It points out that the unrebutted evidence in this proceeding demonstrated that the parties can accurately and inexpensively distinguish FX and VNXX traffic from local traffic for intercarrier compensation purposes. (VZ Exc., p. 12).

Based on the foregoing, Verizon excepts to the ALJ's recommendation because he did not adequately consider the following arguments: (1) federal law does not require payment of reciprocal compensation for interexchange tariffs; (2) payment of reciprocal compensation on virtual NXX traffic would contribute to regulatory arbitrage; and (3) the record establishes that FX and virtual NXX traffic can be practically distinguished from local traffic for intercarrier compensation purposes.

i. Federal Law

Regarding federal law concerning reciprocal compensation of inter-exchange traffic, Verizon states that FCC rules have always made clear that reciprocal compensation under 47 U.S.C. § 251(b)(5) "do[es] not apply to the transport or termination of interstate or intrastate interexchange traffic."[30] The FCC confirmed that

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[30] *Local Competition Order* ¶1034 (Verizon App. Tab 3). This portion of the *Local Competition Order* has never been challenged and remains binding federal law.

result in its *ISP Remand Order* wherein it held that reciprocal compensation does not apply to "interstate or intrastate exchange access, information access or exchange services for such access."[31] As a result, Verizon argues that the FCC's determination that interexchange traffic is not subject to reciprocal compensation binds this Commission and requires it to reverse the ALJ on Issue 6. (VZ Exc., p. 13).

Verizon also cites a recent FCC decision involving *Mountain Communications*,[32] in which the FCC determined that number assignment does not and cannot control intercarrier compensation obligations. Verizon notes that the interconnecting carrier in *Mountain Communications*, as in this case, had a practice of assigning telephone numbers without regard to the customer's physical location. In that case, Verizon states that the FCC explained that the assignment practice "prevents [the originating carrier] from charging its customers *for what would ordinarily be toll calls*."[33] For that reason, the FCC ruled that the receiving carrier was required to compensate the originating carrier for facilities used to transport such calls to its switch.

Verizon reiterates its arguments pertaining to other state commission rulings (*i.e.*, Ohio, Florida, Connecticut, Illinois, Texas, South Carolina, Tennessee, Georgia, and Missouri) that support Verizon's position that reciprocal compensation does not apply to virtual NXX traffic because it does not originate and terminate in the same local calling area. Verizon criticizes the ALJ's recommendation because, it alleges, he never addressed any of those decisions or their reasoning. (VZ Exc., pp. 14-16).

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[31] 47 C.F.R. §51.701(b)(1) (Verizon App. Tab 35).

[32] Order on Review, *Mountain Communications, Inc. v. Qwest Communications International, Inc.*, File No. EB-00-MD-017, 2002 WL 1677642, ¶ 6 (rel. July 25, 2002) ("*Mountain Communications*"), *aff'g* Memorandum Opinion and Order, *Mountain Communications, Inc. v. Qwest Communications International, Inc.*, 17 FCC Rcd 2091 (Chief, Enf. Bur. 2002).

[33] *Id.* ¶5 (emphasis added).

Verizon argues that the three minority opinions relied upon by US LEC on this issue are wholly unpersuasive.[34] Verizon claims that these state commission rulings merely suggest that proper tracking of VNXX traffic would be logistically difficult but did not make any finding as to whether VNXX traffic should be subject to reciprocal compensation under federal law.[35] In the instant proceeding, however, Verizon argues that it adequately explained that: (1) the record in this proceeding establishes that distinguishing FX traffic from local traffic is feasible and, (2) in any event, any alleged difficulties of implementation do not justify ignoring the plain requirements of federal law. (VZ Exc., p. 16).

With regard to the *VA Arbitration Order,* Verizon continues its criticism that this order never addressed the basic question whether VNXX traffic is subject to reciprocal compensation under federal law. Verizon states that the *VA Arbitration Order* is inconsistent with the reasoning of *Mountain Communications,* which Verizon points out, is a decision of the full FCC issued weeks after the *VA Arbitration Order.*

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[34] US LEC has relied on decisions from Michigan, Kentucky, and North Carolina. Verizon notes that US LEC has also cited the decision of the Florida PSC, but the Florida PSC *rejected* application of reciprocal compensation to VNXX traffic. *See supra*, p. 14, n.9.

[35] Moreover, in the case of North Carolina, the North Carolina Utilities Commission (NCUC) authorized payment of reciprocal compensation on *traditional* FX traffic only after adopting the incumbent LEC's proposed interconnection architecture, which required the CLEC, not Verizon, to bear the costs of transporting the call outside the originating local calling area. *See infra*, p. 39, n. 36. Because the ALJ rejected Verizon's proposed interconnection architecture, the North Carolina decision provides no support for the Recommended Decision. *See* Haynes Direct, pp. 11:5-10.

Verizon claims the Wireline Bureau was influenced by the absence of a concrete proposal for distinguishing VNXX traffic from local traffic for billing purposes. It criticizes this as a basis for reaching a result that the parties should not be compelled to give effect to the distinction between VNXX traffic and local traffic, irrespective of the requirements of federal law. Verizon maintains that this reasoning has no application here, because Verizon did present unrebutted evidence that carriers can accurately estimate the volume of FX and VNXX traffic exchanged between them.[36] Thus, Verizon submits that the *VA Arbitration Order* provides no basis for failing to implement the clear requirements of federal law here. (VZ Exc., pp. 16-17).

ii. Regulatory Arbitrage

Verizon objects to the ALJ's reliance on the fact that past industry practice in Pennsylvania has shown that Verizon collected reciprocal compensation for CLEC-originated calls bound for its own FX customers. Verizon explains that prior to 1996, there was no historical practice associated with payment of reciprocal compensation on FX traffic because incumbent LECs did not pay reciprocal compensation to each other. Verizon asserts that it has become increasingly clear, only since the introduction of local competition, that VNXX arrangements are a serious source of regulatory arbitrage, to the point that the assumption that assigned telephone numbers were associated with the physical location of the called party is no longer tenable.[37]

Verizon counters, however, that there is clear historical practice on the appropriate intercarrier compensation with respect to interLATA FX arrangements.

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36 *See* Tr. 232:10-25, 234:4-14, 236:16 - 240:1.
37 Tr. 231-32.